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JOSEPH F. SPANIOL, JR.
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No. 88-302

In the Supreme Court of the United States

OCTOBER TERM, 1988

JAMES A. GORDON, PETITIONER

v.

UNITED STATES DEPARTMENT OF THE TREASURY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether a Maryland statute establishing the priority of various classes of claims against the assets of an insolvent insurance company, Md. Code Ann. art. 48A, §§ 158, 158A (1957), regulates the "business of insurance" within the meaning of Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. 1012(b), so as to avoid the priority conferred by 31 U.S.C. 3713 on claims by the United States.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	1
Argument	5
Conclusion	13

TABLE OF AUTHORITIES

Cases:

Federal Trade Comm'n v. *National Casualty Co.*, 357 U.S. 560 (1958) 10

Group Life & Health Ins. Co. v. *Royal Drug Co.*, 440 U.S. 205 (1979) 3, 9

Idaho ex rel. Soward v. *United States*, No. 87-4057 (9th Cir. Sept. 7, 1988), rev'g 662 F. Supp. 60 (D. Idaho 1987) 5, 6, 11

Langdeau v. *United States*, 363 S.W.2d 327 (Tex. Ct. Civ. App. 1962) 6, 12

Law Enforcement Ins. Co. v. *Corcoran*, 807 F.2d 38 (2d Cir. 1986), cert. denied, 481 U.S. 1017 (1987) 7

Levy v. *Lewis*, 635 F.2d 960 (2d Cir. 1980) 6, 7

Prudential Ins. Co. v. *Benjamin*, 328 U.S. 408 (1946) 9

Robertson v. *California*, 328 U.S. 440 (1946) 10

Securities & Exchange Comm'n v. *National Securities, Inc.*, 393 U.S. 453 (1969) 5, 7, 10, 11

Union Labor Life Ins. Co. v. *Pireno*, 458 U.S. 119 (1982) 3, 4

United States v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944) 8, 9

United States v. *State Bank of North Carolina*, 31 U.S. (6 Pet.) 29 (1832) 13

Constitution and statutes:

U.S. Const.:

Art. I 12

§ 8 10

Cl. 2 (Commerce Clause) 9-10

Constitution and statutes – Continued: Page

Art. VI (Supremacy Clause) 9

Act of Mar. 3, 1797, ch. 20, § 5, 1 Stat. 515 13

Act of Mar. 2, 1799, ch. 22, § 65, 1 Stat. 676 13

McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq.*:

§ 1, 15 U.S.C. 1011 9

§ 2(a), 15 U.S.C. 1012(a) 9

§ 2(b), 15 U.S.C. 1012(b) 3, 5, 8, 9, 10, 11, 12

11 U.S.C. 109(b) 2

31 U.S.C. 3713 ..... 2, 3, 5, 6, 13

31 U.S.C. 3713(a) 2

Idaho Insurers' Supervision, Rehabilitation and Liquidation Act, Idaho Code §§ 41-3301 to 41-3360 (1977 & Supp. 1988) 5

Md. Ann. Code. art. 48A (1957):

§ 158 2

§ 158A 2

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-5a) is reported at 846 F.2d 272. The opinion of the district court (Pet. App. 6a-22a) is reported at 668 F. Supp. 483.

JURISDICTION

The judgment of the court of appeals was entered on May 20, 1988. The petition for a writ of certiorari was filed on August 18, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, a Special Deputy Insurance Commissioner of Maryland, is the receiver of an insolvent insurer, the Eastern Indemnity Insurance Company (EICOM).

EICOM was licensed to do business in Maryland in 1980 and eventually operated in 30 states (Pet. App. 7a). Its principal business was the underwriting of surety bonds for contractors (*ibid.*). In 1985, the Circuit Court for Montgomery County, Maryland, ordered EICOM's liquidation, and it was declared insolvent (*ibid.*). Petitioner was appointed to wind up EICOM's affairs in accordance with the Maryland Insurance Code (*ibid.*). That statute establishes a comprehensive scheme for administering the liquidation of insolvent insurance companies (*id.* at 9a). In particular, it defines the types of claims which may be filed against an insurance company undergoing liquidation, and creates priorities for payment of those claims (*id.* at 9a-10a). See Md. Ann. Code art. 48A, §§ 158, 158A (1957). In this case, the assets of EICOM are far less than would be necessary to satisfy all claimants in full (Pet. App. 7a).

In the liquidation proceeding, the Treasury Department made claims based on performance and payment bonds issued by EICOM in connection with various Miller Act construction projects (Pet. App. 8a). Under the terms of the Maryland statute, these claims would fall within the fourth priority, *i.e.*, "[c]laims by policyholders, beneficiaries, and insureds * * * " (Md. Ann. Code art. 48A, § 158A (1957); see Pet. App. 10a, 44a). The government, however, asserted an absolute priority for its claims under 31 U.S.C. 3713(a). This statute (Pet. App. 24a-25a) requires that a claim of the United States government be "paid first" when an insolvent debtor performs an act of bankruptcy or insolvency.[1]

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[1] Section 3713 does not apply to cases under the federal bankruptcy statute. Insurance companies are excluded from that statute. 11 U.S.C. 109(b).

2. Petitioner contested the government's claim by filing suit in the United States District Court for the District of Maryland. The complaint sought a declaratory judgment that the priority asserted by the government violated Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. 1012(b), which provides that no federal statute "shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * " (see Pet. App. 23a). The district court found that the Maryland liquidation statute is intended to regulate the insurance industry and that enforcement of Section 3713 would invalidate, impair, or supersede the state statute (Pet. App. 12a). However, it held that the McCarran-Ferguson Act does not foreclose the priority Section 3713 confers on the United States because "the liquidation of an insolvent insurance company and the priority of claims paid thereto does not constitute the 'business of insurance' as that term is used in" the Act (Pet. App. 21a).

The district court reached this conclusion after reviewing at length the cases in which this Court has determined whether various activities regulated by state law constitute the "business of insurance" for purposes of the Act (Pet. App. 12a-17a). It determined that the three criteria set forth in *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205 (1979), and *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119 (1982), are "absolutely controlling" (Pet. App. 17a) on the question whether a practice regulated by state law is part of the "business of insurance." These criteria are: first, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within

the insurance industry (*id.* at 15a). See *Pireno*, 458 U.S. at 129.

The district court found that the liquidation statute at issue in this case satisfies none of these criteria. With respect to the first, it explained that the risk that an insurance company will become insolvent is not the kind of risk whose transfer was referred to in *Pireno* and *Royal Drug*. "The obligation of EICOM under its insurance policies to insure against risks of loss is wholly different from the procedure an insurance company must follow to pay claimants in case of insolvency" (Pet. App. 18a). The court also found that the Maryland insolvency scheme is not, in terms of the second prong of the *Pireno* test, "an 'integral part' of the relationship between the insured and the insurer" (*id.* at 20a). The district court explained that "[t]he contractual liability to pay on a policy of insurance is obviously distinct from the question of who gets paid first" (*ibid.*). Finally, with respect to the last of the *Pireno* criteria, the court found that the "liquidation of EICOM and the payment of claims involve entities outside the insurance industry" (*id.* at 21a).

3. The court of appeals affirmed the district court's decision in a brief per curiam opinion (Pet. App. 1a-5a). It rejected petitioner's contention that the district court had erred in relying on *Pireno* and *Royal Drug* "outside of the antitrust context" (*id.* at 4a). The court of appeals also approved the district court's analysis of the three factors set out in those cases, except that it found it unnecessary to decide whether the district court had correctly characterized the first factor as "indispensable" (*id.* at 4a-5a). In all other respects, it adopted the district court's opinion as its own (*id.* at 5a).

ARGUMENT

1. Since the filing of the petition, the Ninth Circuit has joined the Fourth Circuit in holding that state statutes establishing the priority of claims against an insolvent insurance company do not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. See *Idaho ex rel. Soward* v. *United States,* No. 87-4057 (9th Cir. Sept. 7, 1988). In *Idaho,* the Internal Revenue Service asserted priority under Section 3713 for its claims for unpaid federal taxes against two insolvent insurance companies. The Director of Idaho's Department of Insurance, who had taken possession of the companies' assets, argued that they should instead be distributed in accordance with the Idaho Insurers' Supervision, Rehabilitation and Liquidation Act, Idaho Code §§ 41-3301 to 41-3360 (1977 & Supp. 1988), and that Section 2(b) of the McCarran-Ferguson Act made the priority established by Section 3713 inapplicable. The Ninth Circuit, reversing a decision by the district court,[2] held that the United States was entitled to priority. It found that this Court's decision in *Securities & Exchange Comm'n* v. *National Securities, Inc.,* 393 U.S. 453 (1969), compelled the conclusion that Idaho's priority statute "is *not* a law regulating the business of insurance" (slip op. 12544 (emphasis in original)). The Ninth Circuit explained (*ibid.*):

> To begin with, the statute deals with insurance companies that no longer are in the business of insurance. The only "business" being conducted is the liquidation of a corporation which happens to have been an

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[2] *Idaho ex rel. Soward* v. *United States,* 662 F. Supp. 60 (D. Idaho 1987). As a result of the reversal, which postdated the filing of the petition, petitioners can no longer rely on the district court's decision as a basis for urging further review. See Pet. 17-18.

> insurance company. Hence, the scope of the net cast by the statute is wholly unrelated to the relationship between insurer and insured. The insurer has ceased to exist. The only relationship is between the insureds and the government official charged with overseeing the liquidation of the insolvents. * * * The relationship regulated by [the liquidation statute] that is at issue in this case is between the liquidated assets of corporations and the claims of various creditors.

On a "second level of analysis," the Ninth Circuit also joined the court of appeals in this case in concluding that the three criteria set out in *Royal Drug* and *Pireno* require the conclusion that this type of statute does not regulate the "business of insurance" (*Idaho,* slip op. 12545-12549).[3]

Contrary to the suggestion of amicus Superintendent of Insurance of the State of New York (James P. Corcoran Amicus Br. 5-7), these holdings of the Fourth and Ninth Circuits are not inconsistent with any decision of the Second Circuit. In *Levy* v. *Lewis,* 635 F.2d 960 (2d Cir. 1980), and *Law Enforcement Ins. Co.* v. *Corcoran,* 807 F.2d 38 (2d Cir. 1986) cert. denied, 481 U.S. 1017 (1987), the Second Circuit held only that it was appropriate for federal courts to abstain from adjudicating claims against insolv-

[3] The only state court decision to address this issue of which we are aware reached the same result. *Langdeau* v. *United States,* 363 S.W.2d 327 (Tex. Ct. Civ. App. 1962). *Langdeau* rejected the contention that a state statute establishing the priority of claims for unpaid wages against an insolvent insurance company is "a regulation of the insurance business" within the meaning of the McCarran-Ferguson Act (*id.* at 331). Instead, the court said, "it is a priority established for a class of creditors of an insurance company. There are many statutes regulating the rights of persons who may have claims against an insurance company * * *, yet it would hardly be contended that these laws regulate the insurance business simply because they may be invoked against an insurance company" (*ibid.*). The court held, accordingly, that the United States had priority under the predecessor of Section 3713 for its claims for unpaid taxes and interest on them.

ent insurers where a state regulatory scheme committed such claims to a single state court. While the Second Circuit invoked the underlying policy of the McCarran-Ferguson Act and the existence of detailed state regulation of insolvent insurers as factors weighing in favor of abstention,[4] it did not hold that an insurer liquidation statute regulated the "business of insurance" so as to displace inconsistent federal law. To the contrary, in *Levy* the court made it unmistakably clear that the McCarran-Ferguson Act would not preclude the application of federal law (ERISA) to the merits of a claim against an insurer in liquidation, "since the Act was meant only to free state regulation 'of the business of insurance' [quoting *National Securities,* 393 U.S. at 459-460], not regulation of insurers as employers * * *." 635 F.2d at 966. In short, there is no disagreement among the courts of appeals on the issue presented by this case.

2. Nor is there any conflict between the Fourth Circuit's ruling in this case and decisions of this Court. As both the Fourth and Ninth Circuits have now held, a state statute establishing priorities among classes of claims against an insolvent insurer does not, under the three-part test set out in *Pireno* and *Royal Drug,* regulate "the business of insurance." That conclusion is inescapable. Once an insurance company is in liquidation, it is no longer in the business of insurance. While the insurer's assets must be distributed among various creditors, some of which are policyholders with claims based on their policies, a statute establishing the order of payment has nothing to do with the manner in which the policy trans-

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[4] *Levy*, 635 F.2d at 960 (characterizing as "highly significant" the fact that "the state scheme has been adopted pursuant to congressional authorization," *i.e.,* the McCarran-Ferguson Act, and describing the Act as embodying an "express federal policy of noninterference in insurance matters"); *Law Enforcement Ins. Co.*, 807 F.2d at 44 (quoting *Levy*).

fers risk, is not an integral part of the relationship between insured and insurer, and applies not only to entities within the insurance industry (whether insured or insurer) but also to various creditors that have transacted business with the insurer.

Apparently acknowledging the force of the lower courts' application of the *Pireno* criteria, petitioner's principal argument is that those criteria should not apply to this case (Pet. 14-16). Invoking this Court's discussion in *Royal Drug* of the "primary" and "secondary" purposes of the McCarran-Ferguson Act, he contends that *Pireno*'s analysis was meant only to govern the availability of an exemption from the federal antitrust laws (Pet. 12, 14-17). This argument cannot be reconciled with the language of the Act and misapprehends *Royal Drug*'s description of its purposes.

Both *Pireno* and *Royal Drug,* like this case, applied Section 2(b) of the Act. By its terms, this Section resolves any conflict between an "Act of Congress" that does not "specifically relate[ ] to the business of insurance" and a state law "enacted * * * for the purpose of regulating the business of insurance." In this regard, Section 2(b) does not distinguish between antitrust statutes and other Acts of Congress, and thus permits no difference in the meaning of the phrase "business of insurance" depending on what federal statute is involved. If a state law regulates the "business of insurance," it supersedes all inconsistent general federal statutes; if it does not, it is subordinate to all such federal laws.

Royal Drug's description of the two "purposes" of the Act does not suggest a different conclusion. The "primary purpose" of the Act is, as this Court made clear there, "to preserve state regulation of the activities of insurance companies as it existed before the *South-Eastern Underwriters* case [322 U.S. 533 (1944)]," that is, to permit the States to

continue such regulation "without fear of Commerce Clause attack" (*Royal Drug*, 440 U.S. at 218 n.18).[5] This purpose is expressed in Section 1 of the Act, which declares state regulation of the business of insurance to be in the public interest, and is implemented in Section 2(a), which authorizes state regulation of "the business of insurance, and every person engaged therein." [6] This purpose is not implicated in this case, since no one is suggesting that the Commerce Clause precludes any State from enacting a statute of the type in issue here. The "secondary" purpose of the Act, which is embodied in Section 2(b), is to reverse the result that the Supremacy Clause would require when a state law regulating the "business of insurance" comes into conflict with a general federal statute.[7] Though this Court described that purpose in

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[5] *United States* v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), held that interstate insurance transactions constitute "Commerce among the several States" and are thus subject to Congress's power to enact legislation under the Commerce Clause. The decision led to concern, which in retrospect seems overstated, that extensive state regulation of insurance companies would be invalidated by negative implication of the Commerce Clause. See *Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408 (1946).

[6] In this respect, Section 2(a) is broader than Section 2(b). Congress has delegated power to the States to regulate not only "the business of insurance" but also "every person engaged therein." However, such state laws are supreme only if they fall into the first of these categories—*i.e.*, if they regulate "the business of insurance." This distinction between the States' power to regulate and the exemption of their laws from inconsistent general federal statutes evokes this Court's oft-quoted statement that Section 2(b) applies to "the 'business of insurance,' not the 'business of insurers.' " *Royal Drug*, 440 U.S. at 211.

[7] Congress's immediate concern, of course, was that unforeseen conflicts would occur through interpretation of federal statutes in light of *South-Eastern Underwriters'* novel recognition of the breadth of Congress's power to regulate insurance under the Commerce

terms of the antitrust laws in *Royal Drug* (440 U.S. at 218-219), since that was the type of statute involved there, nothing in the Act or its legislative history limits that purpose to any particular kind of federal law. In fact, in *Securities & Exchange Comm'n* v. *National Securities, Inc., supra,* the seminal decision on the meaning of the phrase "business of insurance" for purposes of Section 2(b), the federal statute involved was one of the Securities Acts, and not an antitrust law. Accordingly, application in non-antitrust cases of the three factors in terms of which this Court has further specified "the business of insurance" does not contradict any of the Act's purposes.

Use of the three *Pireno* criteria also does not conflict with the reasoning or results in *Robertson* v. *California,* 328 U.S. 440 (1946), and *Federal Trade Comm'n* v. *National Casualty Co.,* 357 U.S. 560 (1958). See Pet. 15-17. In *Robertson,* a case involving a criminal conviction for a violation of a state insurance statute which had occurred before the McCarran-Ferguson Act's passage, the Court expressly "refrained from explicit reliance upon the Act" in order "to avoid any semblance of retroactive effect in a criminal matter" (328 U.S. at 462). The Court's holdings that the state statute was not invalid under the Commerce Clause and other constitutional provisions did not address any conflict between state and federal statutes and are thus irrelevant to this case. Similarly, the Court's very brief per curiam decision in the *National Casualty* case did not specifically discuss the scope of Section 2(b)'s exemption

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Clause. By contrast, there had never been doubt about the comprehensiveness of Congress's power under Article I, Section 8 of the Constitution to establish "uniform Laws on the subject of Bankruptcies throughout the United States * * *." The statutory term "business of insurance" is properly interpreted in light of these background considerations, as this Court's rationale in the *National Securities* case makes clear (see pages 11-12, *infra*).

for the "business of insurance." In any event, since the activity in issue there, insurer advertising, was closely related to the sale of insurance policies to policyholders, it would have been entirely plausible to find, contrary to petitioner's suggestion (Pet. 16), that those activities were related to the transfer of the policyholder's risk, were a part of the relationship between the insurer and insured, and were limited to entities, *i.e.*, insurers, their agents and potential customers, that are part of the insurance industry.

3. Petitioner and some of the amici suggest that Section 2(b) should be extended to all aspects of "cradle to grave" regulation of insurance companies. Pet. 22; State of Maryland Amicus Br. 5-9; James P. Corcoran Amicus Br. 4-5. However, as the Ninth Circuit correctly recognized, this contention begs the question of whether the specific provision at issue in this case constitutes "the type of regulation that Congress sought to protect from indirect federal preemption by passing the McCarran-Ferguson Act." *Idaho*, slip op. 12549. The unmistakable thrust of this Court's cases is to require a showing that the particular state provision in issue regulates the "business of insurance." It has never been sufficient to show that such a provision is included in a regulatory scheme some parts of which satisfy that test. Petitioner's broad view of the McCarran-Ferguson Act would also run against its legislative history. As this Court explained in *National Securities, Inc.*, 393 U.S. at 458-459:

> The McCarran-Ferguson Act was an attempt to turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation. As the House Report makes clear, "[i]t [was] not the intention of Congress in the enactment of this legislation to

> clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association* case." H.R. Rep. No. 143, 79th Cong., 1st Sess., 3 (1945).

While not dispositive of the issues in this case, this history suggests that Section 2(b) cannot be viewed as a complete exemption for all state "cradle to grave" insurance regulation. As we have explained (note 7, *supra*), Congress's power to establish uniform bankruptcy laws is expressly conferred by Article I of the Constitution and hence long antedates the *Southeastern Underwriters* decision.

4. The persistent undertone of the petition and the briefs filed by the amici is that it is unfair for the United States to obtain priority over other policyholders when an insurance company becomes insolvent. See, *e.g.*, Pet. 6-7, 18-20; Property and Casualty Insurance Guaranty Corporation, et al. Amicus Br. 13-16. However, the scope of the "business of insurance" for purposes of the McCarran-Ferguson Act does not depend on value judgments concerning the relative virtues of conflicting state and federal statutes in a particular case. Moreover, if petitioner's position were adopted, the result would not just abrogate the United States' priority as a policyholder. It would also require the claims of private parties claiming under federal statutes and other types of federal government claims to be subordinated in accordance with whatever scheme of priorities a State might choose to establish. See *Langdeau* v. *United States,* 363 S.W.2d at 331 ("If the preference given by [the state statute] is to prevail over the tax claim of the government, then a State may not only prefer employees of the company, but may prefer every other

claim and make the debt due the United States last. We find nothing in the McCarran Act to warrant this result.").[8] The particular character of the claims at issue in this case does not make it more worthy of this Court's review.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1988

[8] The statute giving the United States priority, 31 U.S.C. 3713, has been in effect since virtually the beginning of the Republic (see Act of Mar. 3, 1797, ch. 20, § 5, 1 Stat. 515, as amended by Act of Mar. 2, 1799, ch. 22, § 65, 1 Stat. 676, and advances the public policy of securing adequate revenue to sustain the public burden and discharge the public debts. *United States* v. *State Bank of North Carolina*, 31 U.S. (6 Pet.) 29, 35 (1832).

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